RULES OF THE

DEPARTMENT OF REVENUE

CHAPTER 810-3-16

Basis for Depreciation and Depletion

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810-3-16-.01. Basis for Depreciation and Depletion.

(1) The basis upon which depreciation and depletion shall be computed is the adjusted basis for determining gain on the sale or disposition of the property, (including any taxes required to be capitalized in connection with the acquisition of a capital asset), as determined under Sec. 40-18-6, except that at the option of the taxpayer:

(a) In the case of mines, or oil and gas wells, depletion may be computed based on discovery value, if the conditions of Code Section 40-18-16(b)(2) are met. (See Reg. 810-3-15-.06(6)).

(b) In the case of oil and gas wells only, for taxable years beginning on or after January 1, 1953, a taxpayer may deduct for depletion an amount equal to 27 1/2% of the gross income from the property during the taxable year, computed on the same basis and subject to the same limitations as provided in the Federal Income Tax Act in effect on September 17, 1953, the effective date of Act No. 719 - 1953 General Acts of Alabama. These limitations on the amount of percentage depletion which may be deducted are:

1. the amount may not be more than fifty percent of the net income from the property before the deduction for depletion, and

2. the amount may not be less than the depletion computed under the cost method.

(2) An election once exercised to claim depletion on the discovery basis or on the percentage basis is irrevocable, and the depletion allowance in respect to each property will for all succeeding tax years be computed in accordance with the election so made. The election to use percentage depletion may be made only with respect to oil and gas wells.

(3) Depreciation and depletion must be charged off on the taxpayer's books, or suitable subsidiary records must be kept to show the basis of the depletable property together with capital additions and all other adjustments. After depreciation or depletion to the extent __ 100 percent of the cost or other income tax basis of the depreciable or depletable assets has been allowed, no further deduction will be permitted, except with respect to depletion when the percentage method is used. Land is not subject to a deduction for depreciation.

(Adopted September 30, 1982; amended February 8, 1989, filed with LRS March 20, 1989, effective April 24, 1989)

Authors: George E. Mingledorff, III
Income Tax Division

Auth: § 40-18-16

810-3-16-.02. Allowable Capital Additions, Mines and Oil and Gas Wells.

(1) All expenditure in excess of net receipts from minerals sold shall be charged to capital account recoverable through depletion while the mine is in the development stage. The mine will be considered to have passed from a development to a producing status when the major portion of the mineral production is obtained from workings other than those opened for the purpose of development, or when the principal activity of the mine becomes the production of developed ore rather than the development of additional ores for mining.

(2) Expenditures for plant and equipment and for replacements, not including expenditures for maintenance and for ordinary and necessary repairs, shall ordinarily be charged to capital account recoverable through depreciation. Expenditures for equipment (including its installation and housing) and for replacements thereof, which are necessary to maintain the normal output solely because of the recession of the working faces of the mine, and which

(a) do not increase the value of the mine, or

(b) do not decrease the cost of production of mineral units, or

(c) do not represent an amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made, shall be deducted as ordinary and necessary business expenses.

(3) Intangible drilling and development cost, such as wages, fuel, repairs, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas, may, at the option of the operator, be deducted from gross income as an expense or charged to capital account. If the taxpayer charges such expenditures as fall within the option to capital account, the amounts so capitalized and not deducted as a loss are returnable through depletion insofar as they are not represented by physical property, and if represented by physical property through depreciation. Expenditures for clearing ground, draining, road making, surveying, geological work, excavation, grading, and the drilling, shooting and cleaning of wells are not considered to be represented by physical property; but expenditures incurred in the installation of casing and equipment and in the construction on the property of derricks and other physical structures are represented by physical property.

(a) If the operator has elected to capitalize intangible drilling and development costs, such costs incurred in drilling a nonproductive well may be deducted as a loss at the election of the taxpayer; but such election must be consistently followed.

(b) The option with respect to intangible drilling and development costs does not apply to expenditures by which the taxpayer acquires property ordinarily

considered as having a salvage value. The option does not apply to any expenditure for wages, fuel, repairs, hauling, supplies, etc., in connection with equipment, facilities, or structures, not incident to or necessary for the drilling of wells, such as structures for storing or treating oil or gas. These are capital items and are returnable through depreciation. Expenditures in connection with the operation of the wells and of other facilities on the property for the production of oil or gas must be charged off as expense.

(Adopted September 30, 1982) §40-18-57

RULES OF THE

DEPARTMENT OF REVENUE

CHAPTER 810-3-17

Items Not Deductible

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810-3-17-.01. Items Not Deductible.

(1) Costs and expenses which are not deductible for income tax purposes include, but are not limited to:

(a) Personal, living, and family expenses such as:

1. Premiums paid for life insurance by the insured.

2. Cost of insuring a dwelling owned and occupied by the taxpayer as a personal residence.

3. Expenses of maintaining a household, including amounts paid for rent, water, utilities, domestic services, etc.

4. Expenses incurred for care of dependent children, even if both spouses work.

5. Losses sustained by the taxpayer upon the sale or other disposition of property held for personal, living, and family purposes.

6. Travel expenses or automobile expenses not deductible under Sec. 40-18-15.

7. Cost of wearing apparel unless such wearing apparel is required as a condition of employment and is not suitable for street wear.

8. Amounts paid as damages, attorneys' fees and other costs of suit to recover such damages. However, damages in settlement of a suit, claim or judgement arising out of a trade or business or transactions entered into for profit are deductible.

9. Attorneys' fees paid in a suit for separation or divorce.

10. Losses sustained and expenses incurred in illegal transactions.

11. Dues to fraternal and social organizations, etc.

12. Gambling losses in excess of gains.

13. Job hunting expenses, other than fees paid to employment agencies.

14. Adoption expenses for tax years prior to January 1, 1991 are not deductible. For tax years subsequent to December 31, 1990, see Reg. 810-3-15-.23.

(b) Capital expenditures. No deduction shall be allowed for:

1. Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate, or

2. Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made in the form of a deduction for depreciation, amortization, or depletion.

(c) Premiums paid on life insurance. Premiums paid on a life insurance policy covering the life of any officer or employee of the taxpayer, or any person (including the taxpayer) who is financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary of the policy.

(d) Organization and financing expenses.

1. For tax years beginning January 1, 1985, Expenses in connection with the organization or reorganization of a business enterprise, such as fees for incorporating, attorneys, accountants, and appraisers, and commissions or other expenses in the issuance or sale of capital stock are properly capitalized when incurred or paid. Such expenses are not deductible from gross income until the business for which the expenses were incurred is abandoned and the business organization itself, or, in the case of a reorganization the successor to the business organization, has been dissolved, or has completely wound up its affairs, whichever is later.

2. For tax years beginning after December 31, 1984, organizational expenditures incurred by a corporation may be amortized over a period of not less than 60 months. See Reg. 810-3-35-.01(7).

3. For tax years beginning after December 31, 1989, certain startup costs may, if the taxpayer so elects, be amortized over a period of not less than 60 months even if the costs do not qualify for amortization as organization fees. See Reg. 810-3-15-23.

(e) Amortization of bond premiums. Premiums paid on bonds purchased by individuals are part of the cost of such bonds, and no portion of such premiums will be allowed as a deduction from gross income until the bonds are sold or redeemed. An exception to this general rule occurs in the case of estates and trusts where the trustee has no alternative other than to protect the corpus of the estate or the trust. In such cases the Department will permit the premium to be amortized over the life of the bond.

(f) Fines and penalties.

1. Fines imposed for violations of law, or penalties imposed for legal infractions, misconduct or failure to adequately or timely comply with laws or regulations are not deductible. Such nondeductible items include:

(i) penalties for late payment or nonpayment of taxes.

(ii) punitive damages imposed by a court for violations of civil or criminal laws (including overweight or speeding fines or penalties).

2. "Penalties" imposed by contract as liquidated damages are deductible. Such items include:

(i) penalties for early withdrawal of savings certificates.

(ii) penalties for failure to complete a construction contract within a specified time.

Author: Mary L. Gifford
Authority: §40-18-17, Code of Alabama 1975
History: Filed with LRS July 22, 1992, certification filed with LRS October 30, 1992, effective December 4, 1992

RULES OF
DEPARTMENT OF REVENUE

CHAPTER 810-3-19

Exemptions - Generally

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810-3-19-.01. Exempt Retirement Allowances.

(1) Income received from retirement systems that is totally exempt from Alabama income tax is as follows:

(a) Retirement allowances, pensions, annuities, or optional allowances paid by Alabama Teachers' Retirement System, the Alabama Judicial Retirement System, and the Alabama Employees' Retirement System and

(b) retirement annuities paid under the United States Retirement System to civil service employees from the United States government civil service retirement and disability fund including income received from the Tennessee Valley Authority's pension system, income received as annuities under the United States foreign service retirement and disability fund or income received from any other United States government retirement and disability fund.

(c) amounts received under the Federal Social Security Acts.

(d) retirement annuities paid under the provisions of the Federal Railroad Retirement Act of 1935, 1937, and 1974.

1. The exclusion from Railroad Retirement Act benefits includes both tier one and tier two benefits.

(e) military retirment (see §40-18-20).

(f) For tax years beginning after December 31, 1990 any retirement compensation, retirement allowances, pensions and annuities, or optional allowances received by any eligible peace officer, as defined in Section 36-21-60(10), or his/her designated beneficiary, from any police retirement system established in the state of Alabama, but only if such retirement compensation, retirement allowances, pensions and annuities, or optional allowances are awarded as a result of police services rendered.

1. An eligible peace officer as defined in Section 36-21-60(10) is:

"A person duly sworn as a peace officer of the state of Alabama possessing powers of arrest and employed by the state, any political subdivision thereof or any municipal corporation therein who is required by the terms of his employment, whether such employment exists by virtue of election or appointment, to give his full time to the preservation of public order and the protection of life or property or the detection of crime in the state. Such terms shall include enforcement officers for conservation laws and full-time coroners, but shall not include any pardon, parole or probation officer, district attorney, assistant district attorney, assistant attorney general, commissioner, deputy commissioner or any municipal inspector, county inspector or state inspector."

(g) For tax years beginning after December 31, 1990, any retirement compensation, retirement allowances, pensions and annuities, or optional allowances, received by any eligible firefighter, as defined in Sections 36-32-1 and 36-32-2, or his/her designated beneficiary, from any firefighting agency established in the state of Alabama, but only if such retirement compensation, retirement allowances, pensions and annuities, or optional allowances are awarded as a result of fire protection services rendered.

(2) Income from retirement systems that is partially exempt from Alabama income tax is as follows:

(a) For tax years beginning after December 31, 1983 and before January 1, 1991, the first $8,000.00 of retirement compensation, retirement allowances, pensions and annuities, or optional alowance received by any eligible peace officer, or his/her designated beneficiary, from any police retirement system established in the State of Alabama, but only if such retirement income was awarded as the result of police services as defined in Sections 36-21-60(10) and 40-18-19 and Regulation 810-3-19-.01(1)(f).

(b) For tax years beginning after December 31, 1986 and before January 1, 1991, the first $8,000.00 of retirement compensation, allowances, pensions and annuities or optional allowances received by an eligible fire fighter (as defined in §§36-32-1 and 36-32-2), or his/her designated beneficiary, from any fire fighting agency established in this state, but only if such amounts are awarded as a result of fire protection services rendered.

(3) Retirement pay annuities received by a retired employee from any retirement system not listed in the preceding paragraphs are subject to tax after recovery of the taxpayer's investment in the system. The taxpayer's investment in the system is the taxpayer's contributions, excluding those allowed as a deduction in determination of Alabama taxable income. Computations, for Alabama purposes, of taxable amounts and the recovery of the taxpayer's investments will be determined in the same manner as used for determining these amounts for federal purposes. Alabama totals will be substituted for federal totals.

Author: Mary L. Gifford, Ann F. Winborne, & Roy Wiggins
Authority: §40-18-19
History: Rule effective October 1, 1982. Amended: Filed July 27, 1988; May 15, 1992.

810-3-19-.02. Personal Exemptions and Credit for Dependents.

(1) (a) General Rule - Resident or Part-year Resident Taxpayers. A single person, or a married person not filing a tax return with their spouse, is entitled to a personal exemption of fifteen hundred dollars ($1,500.00). A head of a family or a married couple filing a joint return is entitled to a personal exemption of three thousand dollars ($3,000.00). If a married couple file separate returns, each must claim a personal exemption of fifteen hundred dollars ($1,500.00).

1. A common law marriage is recognized in Alabama for income tax purposes.

2. Head of Family - years ending before January 1, 1990:

(i) An individual is a head of family within the meaning of §40-18-19 only if he actually supports or maintains in his household one or more dependents (as defined in subparagraph (b)1. below). All of the six factors described below are essential to qualify as head of family:

(I) Taxpayer must be unmarried, and

(II) Taxpayer must provide over fifty percent (50%) of the actual support of the dependent and be entitled to claim the exemption for such dependent on his income tax return, and

(III) The dependent(s) must reside in a household maintained by the taxpayer, and

(IV) The taxpayer must have the right to exercise family control over the dependent(s), and

(V) The taxpayer must be related to the dependent(s) as defined in subpart (b) below and must have a legal or moral obligation to support the dependent(s), and

(VI) The dependent must not have independent means and must be actually dependent upon the taxpayer for support.

(ii) Head of family - years beginning after December 31, 1989. The term "head of family" has the same meaning as "head of household" as described in 26 U.S.C. §2(b) for federal income tax purposes. The judicial and administrative decisions and interpretations of 26 U.S.C. §2(b) will be given due weight in interpreting §40-18-19 as it relates to head of family status.

(I) To be head of family, the taxpayer must be unmarried, or considered unmarried, at the close of the taxable year and not be entitled to claim married filing joint return, as in the year of a spouse's death. The taxpayer is considered not married under 26 U.S.C. §2(b) if --

(A) the taxpayer has been legally separated from his spouse under a decree of divorce or of separate maintenance, or

(B) at any time during the taxable year the taxpayer's spouse was a nonresident alien as recognized for federal income tax purposes.

(II) The taxpayer must maintain as his home a household which also serves as the principal place of abode for any of the following persons--

(A) a son, stepson, daughter, or stepdaughter of the taxpayer, or a descendent of a son or daughter, but only if the son, daughter, stepson, stepdaughter, or descendent is unmarried at the end of the taxable year, except when the taxpayer is entitled to a deduction for the taxable year for the exemption of such son, daughter, stepson, stepdaughter, or descendent, or would be so entitled except that the right to claim such dependent exemption had been relinquished by reason of a signed agreement or court's declaration which provides that the noncustodial parent may claim any deduction allowable for the dependent exemption; or

(B) any other person who is a dependent of the taxpayer, as described in subpart (b), below, if the taxpayer is entitled to a deduction for the taxable year for a dependent exemption for that person, but

(C) if the dependent described in the above provisions would not be a dependent but for --

I. the person has as his principal place of abode the home of the taxpayer and is a member of the taxpayer's household, or

II. the person may be claimed as a dependent under a multiple support agreement as described in 26 U.S.C. §152(c):

then the taxpayer is not entitled to claim the status of head of family.

(III) The father or mother of the taxpayer may qualify the taxpayer as head of family, but only if the taxpayer is entitled to the dependent exemption for the father or mother. The taxpayer must maintain a household which constitutes the principal place of abode of the taxpayer's dependent father or mother, or both, and provide more than one-half of the support of the father or mother. It is not necessary for the taxpayer to reside in the same place of abode as the parent, as is required for other dependents, for the taxpayer to qualify as head of family.

(IV) Maintaining a household for another person is defined as providing more than one-half of the cost of maintaining the home for that person.

(V) Under no circumstances shall the same person be used to qualify more than one taxpayer as the head of family for the same taxable year.

(VI) If, at any time during the taxable year, the taxpayer is a nonresident alien as recognized for federal income tax purposes, the head of family status will not be allowed.

4. Unless otherwise provided (see subparagraph (a)(ii) above), the status of a taxpayer as single, married or head of family will be determined on the last day of the Alabama tax year.

(b) Every taxpayer is entitled to an exemption of three hundred dollars for each person, other than a spouse, who is a dependent of the taxpayer and who received over half of his support from the taxpayer during the calendar year during which the taxpayer's taxable year begins. There is no maximum age limit for a qualifying dependent.

(1) A "dependent" as used in the preceding paragraph is limited to persons having the following relationship to the taxpayer:

(i) son or daughter, or descendant of a son or daughter; or

(ii) stepson or stepdaughter; or

(iii) brother, sister, stepbrother, or stepsister; or

(iv) father or mother or ancestor of either; or

(v) stepfather or stepmother; or

(vi) son or daughter of taxpayer's brother or sister (nephew or niece); or

(vii) a brother or sister of the taxpayer's father or mother (aunt or uncle); or

(viii) son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.

2. The terms "brother" and "sister" include a brother or sister by the half blood. A legally adopted child of a person shall be considered a child of such person by blood.

3. In the case of the birth or death of a dependent, a full dependency exemption is allowed for the year.

(2) Nonresident Taxpayers,

(a) A nonresident must prorate the personal exemption for dependents listed in paragraph (1) above by the ratio of adjusted gross income from sources within this state to total adjusted gross income from all sources. In such cases, a schedule must be submitted with the return explaining the computation of the personal exemption and the exemption for dependents. See Reg. 810-3-14-.05 for the computation of "total adjusted gross income from all sources."

(b) Married nonresident taxpayers may file a joint return, even if only one had income from Alabama sources. The election to file joint or separate returns is irrevocable after the due date for filing the return. If separate returns are filed each taxpayer must claim his or her own personal exemption.

1. EXAMPLE: Taxpayer is a nonresident having adjusted gross income from sources within the State of Alabama of $5,000.00, and total adjusted gross income (including that from within Alabama) of $30,000.00. He is single and has no dependents. He is entitled to deduct as a personal exemption $250.00 ($1,500.00 x $5,000.00/ $30,000.00 = $250.00).

2. EXAMPLE: Taxpayer and spouse are nonresidents. Taxpayer has income from sources within Alabama of $5,000.00 and total adjusted gross income (including that from within Alabama) of $30,000.00. His spouse has no income. He has two dependents (note that a spouse may not be a dependent).

(i) If a joint return is filed, taxpayer is entitled to a personal exemption of $500.00 ($3,000.00 x $5,000.00/$30,000.00 = $500.00) and exemption for dependents of $100.00 ($600.00 x $5,000.00/$30,000.00 = $100.00).

(ii) If a separate return is filed, taxpayer is entitled to a personal exemption of $250.00 ($1,500.00 x $5,000.00/$30,000 = $250.00) and exemption for dependents of $100.00 ($600.00 x $5,000.00/$30,000.00 = $100.00).

1. EXAMPLE: Taxpayer and spouse are nonresidents. Taxpayer has $5,000.00 adjusted gross income within Alabama and total adjusted gross income of $30,000.00. Spouse has adjusted gross income within Alabama of $10,000.00 and total adjusted gross income of $20,000.00. They have two dependents who must be claimed by the taxpayer if the separate returns are filed, since he had the greater income.

(i) If a joint return is filed, the personal exemption will be $900.00 ($3,000.00 x $15,000.00/$50,000.00 = $900.00). The exemption for dependents will be $180.00 ($600.00 x $15,000.00/$50,000.00 = $180.00).

(ii) If a separate return is filed,

(I) The taxpayer's personal exemption will be $250.00 ($1,500.00 x $5,000.00/$30,000.00 = $250.00). Exemption for dependents will be $100.00 ($600.00 x $5,000.00/$30,000.00 = $100.00).

(II) Spouse's personal exemption will be $750.00 ($1,500.00 x $10,000.00/$20,000.00 = $750.00).

4. EXAMPLE: Taxpayer and spouse are nonresidents. Taxpayer has $5,000.00 adjusted gross income within Alabama, and total adjusted gross income of $30,000.00. Spouse has no adjusted gross income in Alabama and total adjusted gross income of $10,000.00. They have one dependent who is claimed by the taxpayer if he files a separate return.

(i) If a joint return is filed the personal exemption will be $375.00 ($3,000.00 x $5,000.00/$40,000.00 = $375.00). Exemption for dependents will be $37.50 ($300.00 x $5,000.00/$40,000.00 = $37.50).

(ii) If a separate return is filed the personal exemption will be $250.00 ($1,500.00 x $5,000.00/$30,000.00). Exemption for dependents will be $50.00 ($300.00 x $5,000.00/$30,000.00 = $50.00).

(3) Special Rules.

(a) If a taxpayer is a resident for part of the tax year, and also a nonresident for part of the tax year, the personal exemption and/or exemption for dependents will be allowed in full on the return as a part-year resident. In such cases, no deduction will be allowed for the personal exemption and/or exemption for dependents on the nonresident return.

(b) 1. In the event a taxpayer makes a change in the tax year (from calendar year to fiscal year, from fiscal year to calendar year, or from one fiscal year to another fiscal year) as provided in §40-18-30, the deduction for the personal exemption and/or for dependents must be prorated for each year that is less than twelve months by the ratio of the number of months in the tax year divided by twelve. No proration is required if the change in the tax year is caused by the death of the taxpayer.

2. For example, if a taxpayer changes from a calendar year to a fiscal year ending June 30th., the maximum allowable deduction for the personal exemption would be $750.00 for a single person (6/12 x $1,500.00 = $750.00) or $1,500.00 for a married couple or head of family (6/12 x $3,000.00 = $1,500.00), for the 6-month short-period following the change.

(c) In no event may any combination of status as a resident or nonresident, or as single, married, or head of family, result in a deduction for personal exemption of more than $1,500.00 for one individual, $3,000.00 for a married

couple, or $3,000.00 for a head of family in any one tax year; nor more than $300.00 for each individual dependent for any one tax year.

(d) The terms "dependent exemption" and "exemption for dependent": as used in this and other regulations, as well as the forms used for filing Alabama income tax returns, shall mean that deduction referred to as "credit for dependents" in §40-18-19(b), Code of Alabama 1975.

Author: Anne Simms & Ann F. Winborne
Authority: §40-18-19
History: Rule effective October 1, 1982. Filed with LRS October 21, 1991.
Amended: Filed May 15, 1992 effective June 19, 1992.

810-3-19-.03. Income Realized from a Financial Business.

(1) Net income realized in conducting a business subject to the excise tax on financial institutions imposed by Sections 40-16-1, et seq., and where such excise tax is paid, is excluded from gross income under the provisions of Chapter 18 of Title 40.

(2) Salaries paid by businesses subject to the financial institution excise tax, allowed as deductions to such businesses under Sec. 40-16-1(2)(a) are included in gross income of the recipient for income tax purposes under Chapter 18.

(Adopted September 30, 1982; Amended: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Rebecca S. Whisenant
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Auth: § 40-18-19

810-3-19-.04 Defined Benefit Plans.

(1) Effective January 1, 1991, payments made on or after such date to a retiree or his designated beneficiary under a "defined benefit plan," as defined by IRC §414(j), as amended from time to time, to the extent such payment would be taxable for federal income tax purposes.

(2) A "defined benefit plan" is any plan that is not a "defined contribution plan." A "defined contribution plan" is a plan that provides an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and for income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participants' accounts. This includes plans such as profit sharing, stock bonus, and money purchase pension plans. These plans "could" be Keogh, SEP, or IRA plans. In a "defined contribution plan" such as a money purchase plan, contributions will be specified (not based on profits) and the benefits are whatever these contributions will provide. "Defined benefit plans" may include pension and annuity plans, but all plans are to necessarily "defined benefit plans." A "defined benefit plan" is one in which the contributions are based on a computation of what contributions are needed to provide definitely determinable benefits to plan participants. That is, contributions are dependent on promised benefits. Contributions to the plan are actuarially calculated to provide the promised benefits.

(3) (a) A lump-sum distribution, received by a retiree from a defined benefit plan, which is rolled over into another type of retirement plan or account is not taxable and is considered as basis in the new account.

(b) Distributions rolled into an individual retirement account (IRA) are not deductible as an adjustment to income.

(c) Any earnings or income produced by the amount invested in another plan or account represents taxable income. The taxable portion of distributions from the account is computed pro rata, similar to nontaxable IRA distributions.

(4) A lump-sum distribution from a defined benefit plan, received by a person who is not retired, is taxable as an early distribution unless the distribution is rolled over into another plan.

(5) Benefits received from nonqualified excess benefit plans or supplemental employment retirement income plans (SERP's) are taxable. Excess or supplemental benefits which exceed the limits set by the Internal Revenue Code are not considered as tax exempt benefits received from a defined benefit plan.

(6) Where a combination of plans exists requiring the benefits from a defined benefit plan to be reduced, distributions in excess of the amount distributed

from the defined benefit plan are taxable. Even though the recipient could have received more from the plan had a combination of plans not existed, only the amount actually distributed from the defined benefit plan is exempt from tax.

Author: Anne Simms and Ann Winborne, Income Tax Division
Authority: §40-18-19, Code of Alabama 1975
History: Rule effective October 1, 1982. Amended: Filed July 27, 1988; filed May 15, 1992, effective June 19, 1992

RULES OF
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CHAPTER 810-3-21

CREDIT FOR TAXES PAID ON INCOME
FROM SOURCES OUTSIDE THE STATE

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810-3-21-.01 Credit for Taxes Paid to Another State or Territory.

(1) For all taxable years beginning after the Multistate Tax Compact became effective in 1977, and taxable years beginning before January 1, 1997, resident taxpayers, including individuals, engaged in multistate business in such a manner as to subject their income to allocation and apportionment provided by the Multistate Tax Compact were not allowed a credit for taxes paid to other states or territories. For tax years beginning after December 31, 1996, resident individuals are not required to allocate and apportion income and the credit for taxes paid to other states and territories, as provided in this section, is allowable for all individuals.

(2) See Reg. 810-3-162-.01 for credit allowed to shareholders of an Alabama S corporation for taxes paid by the shareholders to other states on S corporation earnings.

(3) For all individuals with taxable years beginning after December 31, 1996:

(a) Any Alabama resident individual with gross income from sources outside Alabama which is includible in Alabama gross income and also in another state or a territory of the United States, is entitled to a credit against the income tax due to Alabama, as described below.

I. The amount of credit will be the lesser of the amount of income tax actually paid to another state on the same income, or the tax computed on the same taxable income in the other state using Alabama tax rates.

(i) When income tax is paid to more than one other state, the tax credit must be computed separately for each state.

(ii) When a state allows credits against its tax in lieu of exemptions, the taxable income in that state will be determined after a deduction computed by converting the credit at the lowest rates applicable in that state.

(I) EXAMPLE: Taxpayer, a resident of Alabama, has taxable income in Alabama, in State X and in State Y. Taxpayer is filing a joint return with his spouse.

	Taxable Income	Tax on Taxable Income	Tax on Tax-able Income at Alabama Rates	Credit Allowable
State X	$ 9,000	500.00	373.00	373.00
State Y	4,000	60.00	142.00	60.00

Alabama	23,000	1,073.00	
Total credit allowable			433.00
Total Alabama income tax		$1,073.00	
Less credit for tax paid to other states		433.00	
Tax due Alabama		$ 640.00	

(II) EXAMPLE: Taxpayer, a single individual and a resident of Alabama, has gross gambling income of $50,000 and $50,000 gambling losses in State A. State A only allows a deduction for a percentage of gambling losses ($30,000 in this example) but Alabama allows a deduction for gambling losses up to the amount of gambling income ($50,000 in this example). Taxpayer pays tax to State A on $20,000 net gambling income but does not pay tax to Alabama on any gambling income. In this situation, there is no credit for tax paid to State A because the net income from gambling on the Alabama return is zero and, therefore, there is no double taxation.

(III) EXAMPLE: Same situation as (II) above, except gambling losses are $40,000, with a net taxable income from gambling of $10,000 on the Alabama return and $20,000 in State A. In this instance, the credit allowed will be the lesser of tax at the Alabama rate on $10,000 or tax in State A on $10,000. Credit is allowed for tax on $10,000 only because this is the amount of income that otherwise would be subject to double taxation without the credit.

2. Credit for taxes paid other states will be administratively applied as if payment were made on the due date of the applicable return against any liability due Alabama. The amount of any estimated taxes due under § 40-18-82 will be reduced by the amount of any credit allowed under this regulation.

(b) A resident claiming the credit for taxes paid to another state must attach to his Alabama income tax return a copy of each nonresident return filed showing the amount of the tax payment claimed as credit. The Department may require a certified copy of the return or a certificate showing the amount of tax paid.

(c) The credit is allowed to a taxpayer who reports on the cash basis even though the tax due to another state was not actually paid during the year for which the credit is claimed, as long as the tax is actually paid to the other state. The credit is allowed only on the return for the year in which the income is taxable by the other state. For instance, a credit will be deducted on a 1997 return for tax due on 1997 income which is payable in 1998.

(d) If a resident individual is included in a joint return in another state, the Alabama credit allowable for taxes paid the other state must be apportioned to each individual. The allowable share will be a fraction, the numerator of which is

the tax the individual would have paid the other state on his separate income, and the denominator of which is the total amount that each would have paid the other state; applied to the tax liability due the other state. If either individual has a negative or zero tax liability, no credit will be allowed that individual. The allowable credit in any instance will not be more than the amount due at Alabama rates.

(e) Taxable income of a nonresident includes only income derived from sources within the state, and therefore, no credit is allowable for taxes paid to other states.

Author: Rebecca S. Whisenant.
Authority: §40-18-21, Code of Alabama, 1975.
History: Adopted September 30, 1982.
Amended: Filed October 26, 1988, effective December 2, 1988.
Amended: Filed March 26, 1998, effective April 30, 1998.
Amended: Filed April 28, 1999, effective June 2, 1999.

810-3-21-.02 Credits for Job Development Fees.

(1) Any taxpayers who is subject to the personal income tax imposed by Section 40-18-2 and has had a Job Development Fee withheld from the taxpayer's wages by an Approved Company pursuant to Section 41-10-44.8(b) is allowed a credit against the taxpayer's state personal income tax liability for the year in which the Job Development Fee has been withheld. The credit is allowed to the taxpayer in an amount equal to the Job Development Fee withheld from the taxpayer's wages by the Approved Company during such year.

(a) The Job Development Fee credit allowed pursuant to paragraph (1) above shall be included in computing the taxpayer's total withholding tax liability pursuant to Section 40-18-71.

(b) In the event that the Job Development Fee withheld from a taxpayer's wages during the year by an Approved Company exceeds the taxpayer's state personal income tax liability for such year, the taxpayers shall be entitled to a refund. Such refund shall be issued to the taxpayer by the Department in an amount equal to the difference between the taxpayer's state personal income tax liability and the Job Development Fee withheld from the taxpayer's wages by the Approved Company.

Authors: Tina M. Melancon and Ann F. Winborne
Income Tax Division
Authority: Section 40-18-21 and Act 93-852, Code of Alabama 1975
History: New rule filed: August 26, 1994, effective September 30, 1994.

RULES OF
DEPARTMENT OF REVENUE

CHAPTER 810-3-24

Taxation of Partnerships

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810-3-24-.01 Taxability of Partnership Income.

(1) (a) A partnership is considered to be a "conduit" of income to each partner and not a taxable entity under Alabama income tax law.

(b) The term "partnership" includes a limited partnership as well as a general partnership, and a syndicate, group, pool, or joint venture which is not a corporation, estate, trust or sole proprietorship within the meaning of the Alabama income tax law.

(c) The term "partner" means any person who is a member of a partnership.

(d) The term "person" as used in this regulation includes an individual, corporation, fiduciary or another partnership.

(2) A partnership, once established, continues until:

(a) no part of any business, financial operation or venture of the partnership continues to be carried on by any of its partners as a partnership, or

(b) 50% or more of the total interest in partnership capital and profits is sold or exchanged within a period of twelve consecutive months.

(3) (a) Each partner shall include in gross income from all sources, the distributive share of the income (or loss) of a partnership for any partnership year ending within the partner's taxable year. For an Alabama resident, this amount will also be included in Alabama gross income.

(b) Each nonresident partner shall include in Alabama gross income the distributive share of partnership income (or loss) attributable to Alabama as provided in Reg. 810-3-24-.02(2). For the purpose of apportioning deductions based on the ratio of Alabama adjusted gross income to total adjusted gross income, total adjusted gross income will include the nonresident partner's full share of the partnership income, and not just the portion attributable to Alabama.

(4) The Internal Revenue Code contains provisions similar to those in § 40-18-24. The Department will consider administrative rulings and judicial decisions in respect to the similar provisions of federal law and regulations in interpreting this regulation.

(Adopted September 30, 1982; amended February 8, 1989, filed with LRS March 20, 1989, effective April 24, 1989)

Authors: Ecta Spicer, Roy Wiggins and John H. Burgess

Auth: § 40-18-24

Income Tax Division

810-3-24-.02 Computation of Partnership Income (or Loss).

(1) The net income of a partnership is computed in the same manner as that of an individual, except:

(a) no deduction is allowed for a personal exemption or credit for dependents as provided in § 40-18-19, and

(b) no deduction is allowed for charitable contributions or gifts made in accordance with § 40-18-15(a)(10), and

(c) no deduction is allowed for a net operating loss carryback or carryforward as provided in § 40-18-15(a)(16), and

(d) no deduction is allowed for the additional itemized deductions provided for individuals in § 40-18-15, and

(e) no deduction is allowed for the optional standard deduction provided in § 40-18-15(b).

(2) A partnership doing business in Alabama and at least one other state must compute income attributable to Alabama in the manner provided in Reg. 810-3-31-.02 for foreign corporations.

(Adopted: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Ecta Spicer, Roy Wiggins and John H. Burgess
Income Tax Division

Auth: § 40-18-24

810-3-24-.03 Partner's Distributive Share of Partnership Income (or Loss).

(1) A partner's distributive share of partnership income, gains, losses and deductions shall be determined in accordance with the partner's interest in the partnership (taking into account all facts and circumstances) unless -

(a) the partnership agreement provides otherwise, and

(b) the allocation to a partner in accordance with the partnership agreement is not substantially for the purpose of avoiding or evading taxation under this regulation.

(2) The character of any item of income, gain, loss or deduction included in the partner's distributive share of partnership net income (or loss) shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

(3) (a) A partner's distributive share of partnership net income (or loss) includes any "Guaranteed Payments to Partner" as defined in Reg. 810-3-24-.04. The distributive share is included in gross income of the partner as provided in Regs. 810-3-14-.01 (for residents) and 810-3-14-.05 (for nonresidents) or 810-3-34-.01 (for corporations).

(b) A partner is also entitled to a proportionate share of any contributions made by the partnership which would be deductible under § 40-18-15(a)(10). See Reg. 810-3-15-.17.

(4) A partner's distributive share of partnership loss shall be allowed only to the extent of the adjusted basis (before reduction by the current year loss) of such partner's interest in the partnership at the end of the partnership taxable year in which such loss occurred. If a partner's distributive loss exceeds the adjusted basis in the partnership interest -

(a) the amount of the loss that exceeds the partner's adjusted basis will not be allowed as a deduction for that year, and

(b) any loss disallowed in subparagraph (a) above shall be allowed as a deduction at the end of the first succeeding partnership taxable year and subsequent partnership taxable years to the extent that the partner's adjusted basis in his partnership interest at the end of such year exceeds zero.

(5) In any case where it is necessary to determine the gross income of a partner, such amount shall include his distributive share of the gross income of the partnership.

(Adopted: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Ecta Spicer, Roy Wiggins
and John H. Burgess
Income Tax Division

Auth: § 40-18-24

810-3-24-.04 Transactions between Partner and Partnership.

(1) A partner who engages in a transaction with a partnership other than in his capacity as a partner shall be treated as if he were not a member of the partnership with respect to such transaction. In all cases the substance of the transaction will govern and not its form. The relationship between a partner not acting in his capacity as a partner and the partnership may include, but is not limited to, that of creditor-debtor, vendor-vendee and employee-employer.

(2) To the extent determined without regard to the income of the partnership, payments to a partner for services or for the use of capital shall be considered as made to one who is not a member of the partnership. Such guaranteed payments to partners shall be treated as a deductible business expense in the computation of the partnership net income.

(3) (a) Gain or loss will be recognized by a partner on a contribution of property to a partnership in exchange for an interest in the partnership to the extent provided in § 40-18-8.

(b) 1. Gain or loss will be recognized by a partnership on a distribution of property to a partner to the extent provided in § 40-18-8.

2. Gain or loss will be recognized by a partner on a distribution of property from a partnership to the extent provided in § 40-18-8.

(Adopted: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Ecta Spicer, Roy Wiggins and John H. Burgess
Income Tax Division

Auth: § 40-18-24

810-3-24-.05 Partner's Basis in Partnership Interest.

(1) A partnership interest is personal property held for the production of income. A gain or loss from the sale or other disposition of a partnership interest must be recognized to the extent provided in § 40-18-8.

(2) The adjusted basis of a partner's interest in a partnership shall be the amount of property, including money, contributed to the partnership:

(a) increased by the sum of his distributive share (not including any "Guaranteed Payments to Partners") for the taxable year and prior taxable years of;

1. the taxable income of the partnership,

2. the income of the partnership exempt from tax, and

3. the excess of the deductions for depletion over the basis of the property subject to depletion,

(b) decreased (but not below zero) by distributions by the partnership and the sum of his distributive share for the taxable year and prior taxable years of -

1. losses of the partnership, and

2. expenditures of the partnership not deductible in computing its taxable income and not property chargeable to the capital account.

(3) (a) Any increase in a partner's share of the liabilities of a partnership, or any increase in a partner's individual liabilities by reason of the assumption by such partner of partnership liabilities shall be considered as a contribution of money by such partner to the partnership.

(b) Any decrease in a partner's share of the liabilities of a partnership, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of such individual liabilities, shall be considered as a distribution of money to the partner by the partnership.

(4) (a) If a partner makes a contribution of property subject to a liability to a partnership, and the partnership assumes the liability, the amount of the liability (not exceeding the fair market value of the property at the time of the contribution) will be considered a contribution to the partnership in the amount of the liability that is not allocated to the other members of the partnership.

(b) If property subject to an indebtedness is distributed by a partnership to a partner, and the liability is assumed by the distributee, the amount of the liability,

(not exceeding the fair market value of the property at the time of the distribution) will be considered to be a contribution to the partnership in the amount of the liability that had been allocated to the other members of the partnership.

(Adopted: June 17, 1988; Filed with LRS: July 27, 1988)

Authors: Ecta Spicer, Roy Wiggins and John H. Burgess

Auth: § 40-18-24